Postal Regulatory Commission
Submitted 5/7/2012 4:27:05 PM
Filing ID: 82387
Accepted 5/7/2012

Before the
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Institutional Cost Contribution
Requirement for Competitive Products

Docket No. RM2012-3

REPLY COMMENTS OF THE PUBLIC REPRESENTATIVE

(May 7, 2012)

The Public Representative offers these reply comments on the Commission's review of the institutional cost contribution requirement for competitive products. These comments are primarily directed on the initial comments of the United Parcel Service (UPS) and the Postal Service.

UPS Proposal

UPS has recommended that the Commission change the competitive products institutional cost share from a static 5.5% to a methodology that would "self-correct" itself as competitive products grows in relation to the decline in market dominant products. UPS comments at 9. This methodology would, as UPS claims, ensure that competitive products would pay for the institutional costs that are more proportional to its use of the Postal Service's infrastructure and would make up for the decreasing contributions from market dominant products. Some of the methods mentioned that could be used include an appropriate share that is based on attributable costs or another burden type methodology. UPS also says that share of volumes or revenues would also be appropriate market based methodologies. Id at 9-10.

UPS cites, in part, the ongoing decline in First-Class volumes and revenues, and the decline in institutional cost contribution from market dominant products as a whole. The increasing share of volumes and revenues, and hence the increasing capability of competitive products to contribute more to the coverage of institutional costs justify the jettisoning of the current static 5.5% required contribution from competitive products. Id at 7. Additionally, the transfer of products from the market dominant product list to competitive products further enhances the ability of competitive products to higher contributions. These additions to the competitive product list also, as UPS asserts, will not make any contributions to the institutional costs as long as the initial products[1]revenues are sufficient to cover the required 5.5% minimum contribution. All other net revenues from the newly transferred products will go directly to the Competitive Products Fund. These transfers alone would necessitate an increase in contribution, according to UPS. Id at 8.

The Public Representative has already commented on the declines in market dominant volumes and revenues, especially First-Class and Standard Mail. The comments also noted that competitive products volumes and revenues have increased over this same time period. Additionally, the transfer of some market dominant products to competitive products has already had a significant impact on the volumes and revenues generated by competitive products. However, the effect of the rising volumes and revenues, both from increased volumes of the original competitive products and the newly transferred market dominant products, on the costs, especially the competitive products contribution to institutional costs, are still unknown.

Contrary to the position taken by UPS, competitive product volumes and revenues are not the only parameters to be taking into consideration when evaluating the appropriate share from competitive products. As the Postal Service has rightly noticed in its initial comments in this rulemaking docket, the structure of the institutional cost pool and the effect of outside influences do make a difference in the amount of total net revenues that are generated by the competitive products. While UPS has noted that competitive products generated its largest after-tax profit in FY 2011, what they fail to note is that this additional net revenue was due to the decline in institutional costs due to the deferral of the retiree health benefits fund payment of $5.5 billion, most of which

[1] The Public Representative is assuming that the “initial products” UPS is referring to are Priority Mail, Express Mail, Parcel Select, Parcel Return Service, and competitive international products.

is an institutional cost. Both the Postal Service and the Public Representative presented tables in their initial comments showing how the contribution to institutional costs by competitive products are reduced when the deferrals of payments to the retiree health benefits fund are included in the institutional cost pool. The Public Representative's version of the table is presented below.

Competive Product Share
Of Institutional Costs
FY 2007 - FY 2011

	Contribution to Institutional Costs	Adj. Contribution to Institutional Costs
FY 2007	5.66%	5.66%
FY 2008	5.54%	5.54%
FY 2009	6.78%	5.96%
FY 2010	7.12%	7.12%
FY 2011	7.82%	6.59%

An increase in the institutional cost pool can reduce the total net revenue of competitive products by almost 1% - 1.3%, as shown in the table above. Additionally, the Public Representative has noted that there could be significant structural changes to Postal Service costs in the near future. The recent passage of S. 1789 contains several provisions that could significantly affect the costs of the Postal Service.[2]

These uncertainties do not lend itself to a significant change in the current appropriate share from competitive products. If the Commission were to contemplate any changes, serious consideration and analysis is needed on the future cost implications of any business model changes currently being considered.

Even if the Commission agrees with UPS and wants to establish a "…variable, self-adjusting mechanism…" to determine the proper appropriate share, UPS has not provided a distinct methodology to accomplish this. It is not clear what methodology UPS is advocating and is apparently relying on the Commission's expertise to

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[2] Among some of the provisions are changes to the retiree health benefits financing, allowing the Postal Service to establish their own health benefits program, and the use of almost $11 billion of FERS pension system surpluses to finance employee voluntary separation and debt reduction.

determine it for them. Without a clear understanding of exactly what UPS is proposing in terms of execution and method, it is difficult to properly vet its proposal.

Postal Service Proposal

The Public Representative does not find any fault with the Postal Service's argument to maintain the current 5.5% appropriate share from competitive products. However, the rule modification proposed by the Postal Service should not be regarded lightly. While the Public Representative is not entirely against this proposal, the Commission should take note that any circumstance that would cause competitive products to not reach the 5.5% contribution threshold can be readily and quickly remedied by the Postal Service. That is, the Postal Service has significantly more flexibility in changing prices or services for competitive products than they have for market dominant products and any circumstance, short of an event which would occur within the last month of a fiscal year, which would threaten the ability of competitive products to meet the mandated 5.5% minimum contribution to institutional costs could be readily corrected by the Postal Service to ensure compliance with the required institutional cost contribution.

Summary

In summary, the Public Representative encourages the Commission to maintain the current 5.5% minimum institutional cost contribution from competitive products. The Public Representative would also recommend that the Commission, reserve its right to institute further review of the appropriate share at any time before the next five year review if the actual contribution from competitive products is significantly above or below the minimum required.

Respectively Submitted,

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Public Representative